

Research-in-Brief

Taxing Women — How the Tax Code Discriminates Against Women and Families

This Research-in-Brief summarizes an important new book by Edward J. McCaffery, professor of law at the University of Southern California Law School and the California Institute of Technology. Published by the University of Chicago Press in 1997, Taxing Women discusses how the U.S. tax system continues to discriminate against women and their families.

If the federal government passed a law imposing steep fines on married women who tried to work outside the home, citizens would likely be outraged, writes Edward J. McCaffery in his new book, Taxing Women. But the deep biases of the U.S. tax system, which have just that effect, linger unchallenged and unexamined.

The tax system goes to the heart of the kinds of people Americans are and hope to become. It affects such personal issues as whether or not to marry or have children; to work full-time or part-time (outside or inside the home); to give to charity; to buy or sell a home; to pursue education; to retire; and to pass on wealth to heirs. But people don't usually complain about how taxes shape their lives, only about the bottom line -- how much they have to pay.

Tax Code Based on the "Traditional" Family

The tax code is in many ways opposed to the modern family, especially for middle-class and poor households. Major structural decisions about the tax laws were made in the 1930s and 1940s, when the traditional, single-income family—with the man employed full-time outside the home and the woman employed as homemaker—dominated. Social policy makers have since made choices that have rewarded and fostered this model.

The net result is that today's tax system has severe penalties for two-income families. Statistics show that the *average* two-income family sees two-thirds of the wife's salary lost to taxes and work-related expenses. Many employed wives lose even more than this average, of course.

The gender biases of taxes, however, remain obscure, partly because they are contained in

several different structural elements of the tax code. Only when the tax system is viewed as a whole and in the context of daily life is the depth of the problem seen. Although the language of the tax code is gender-neutral, the law is biased against secondary earners, who are primarily women. On average, an employed wife earns about 60 percent of her husband's salary. Culturally conditioned attitudes and practices and the inequities of the labor market tend to make women's jobs lower-paying per hour and, often, less than full-time. Thus, women's earnings may often be viewed as secondary within the family, even though on average wives are providing a substantial share of family income.¹

Critics of the tax system often argue that the system is biased in favor of working women and against wives and mothers who choose not to work for pay and remain at home. Actually, the opposite is true. There are at least six ways in which the tax code works against married women's employment.

Joint Filing and Income Splitting under the Federal Income Tax System

Beginning in 1948, federal income taxes allowed married couples to file jointly and “split incomes.” Thus, if the husband earned \$60,000 and the wife earned nothing, taxes could be paid as if there were two \$30,000 earners -- an advantage, given progressive taxation, by which successive amounts of income are taxed at incrementally higher rates. Nearly all married couples in the United States file joint tax returns since there is no economic incentive for filing separately. But problems arise for women and families because of progressive marginal rates. For example, if a husband in a family of four earns approximately \$17,000, his wife enters the workforce subject to a 15 percent federal income tax on her earnings; if he earns \$57,000, her earnings would be subject to a 28 percent rate no matter how low her own earnings. Given progressive tax rates, which can be justified on equity grounds (and in any case have been dramatically reduced), joint filing and income splitting benefits married couples with only one earner and tends to disadvantage couples with two earners. In particular, high marginal tax rates discourage the lower earner from working at all.

The Structure of Social Security

The Social Security system as currently structured also works against employed wives. By providing benefits for women who stay home on the same terms that apply to most working wives, the system creates a problem for working wives. Employed wives generally receive no added benefits from the Social Security taxes they have paid because they are already entitled to spousal benefits regardless of their own employment. Under the current Social Security system, a wife is entitled to receive her own contribution’s worth of benefits or at least half of her husband’s, whichever is greater (the same is true for a husband -- he could collect benefits based on his own or his wife’s earnings record). Since most wives receive more money from half of their husband’s benefit than from their own contribution, most married women get no benefit from their own contributions.

For example, if a husband earns \$30,000 and his wife takes a job paying \$10,000, she will contribute \$1,530 to the Social Security system annually -- half coming directly out of her paycheck and half coming from her employer. Because her own benefit would be significantly smaller than the spousal

Table 1.
Costs and Benefits of Wife’s Work Under Social Security System

Family Wage Pattern*	Increase in Social Security Taxes Due to Wife’s Working	Increase in Social Security Benefits Due to Wife’s Working
Husband High/ Wife Average	43.3%	1.0%
Husband Average/ Wife Low	46.6%	1.2%
Husband Low/ Wife Low	103.6%	15.2%

* In 1994, a “high wage” individual made \$60,000 a year, an “average wage” individual made \$24,444, and a “low wage” individual made \$11,000.

Source: Edward J. McCaffery, *Taxing Woman*, p. 97, based on Eugene Steuerle and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, Urban Institute, 1994.

benefit, and because she is entitled to the spousal benefit even if she did not work for pay, this wife will get *no* return from this \$1,530 in taxes. She will have paid taxes, but reaped no direct benefit.

This “double taxation” of the working wife through both her own and her husband’s Social Security tax payments is a sizeable problem. The Social Security system has grown enormously since the 1930s, to the point where most Americans pay more in FICA than in income taxes.

As Table 1 illustrates, married couples consisting of two low-wage earners pay especially high Social Security taxes and receive little added benefit.

The Non-Taxation of “Imputed” Income

When a woman stays home and cares for her children and the house, she is of course providing a significant economic benefit: the care of her children, who will one day be members of the workforce. But she and her husband are not taxed on the value of this service, a service that scholars refer to as “imputed” income. While there are good reasons not to tax such income, its non-taxation, nonetheless, creates a severe bias.

Mothers who are employed can easily find themselves in a 50 percent marginal tax bracket because of federal income, Social Security, and state and local taxes. If we assume that a wife who stays home and cares for her children earns \$10,000 in imputed income, then a wife who wants to work outside the home would have to earn \$20,000 merely to replace her imputed income and the earnings she would lose to taxes. Half of her money would go to the government, and the other half would need to be spent on child care and other costs associated with her decision to work (equivalent to the imputed income of the stay-at-home wife). Little added benefit would come to the family from this employment. This leads many married mothers to stay home and other families to cut corners on child care and other work-related costs. If the imputed income of stay-at-home wives were also taxed, the decision to work outside the home would be less affected by tax bias; a similar result would follow from more generous deductions for child care and other work-related expenses of two-earner couples.

Inadequate Child Care and Other Work-Related Deductions

Adequate deductions for child care and other work-related expenses would provide an economic incentive for more women to work outside the home, or at least neutralize the effects of favorable tax treatment for stay-at-home wives. Currently, however, there is no general deduction for such costs. A rather limited secondary-earner deduction was instituted in 1981 to provide some help for employed wives, but it was repealed five years later. The existing dependent-care tax credit is very limited in its practical effects; one study of 1983 tax returns found that fewer than 18 percent of families with dependent children claimed any child care credit at all, and the average benefit was well under \$500 a year -- less than \$10 a week. The recently enacted per child credit of \$500 goes equally to families with working and non-working wives and does nothing to redress the bias against working wives. Despite the recent tax reform (passed in August 1997), most married mothers who work outside the home still face high marginal tax rates.

Fringe Benefits

Many fringe benefits, the most important being medical insurance and pension plans, are deductible business expenses to employers but are not considered income to employees. Thus, there is a strong tax incentive for employers to “pay” employees these benefits, rather than raising their salaries. About 30 percent of compensation to today’s workers comes from these noncash benefits, which extend beyond individual workers to cover the entire family. In many cases, employees have no choice but to accept certain fringe benefits. Much in the same way as Social Security, this system provides no meaningful benefit for many employed wives. Many women are offered benefits that they do not need because they already receive such benefits from their husband’s employer, and they are not allowed to take the cash equivalent. Once again, the tax system provides a benefit to stay-at-home wives and disadvantages employed wives by encouraging employers to offer them benefits that provide no additional gains, instead of offering them a higher salary.

Table 2.
Sample Marriage Penalties, Families with Two Children

Husband's Earnings	Wife's Earnings	Marriage Penalty*
\$10,000	\$10,000	\$3,717
15,000	10,000	2,600
20,000	20,000	600
25,000	25,000	727
50,000	30,000	2,418

* Additional federal income tax paid by this couple when married compared to the same individuals if unmarried. Very high marriage penalties for low-income families are the result of the rapid phase-out of the Earned Income Tax Credit at incomes above \$15,000 and the lack of any adjustment to the credit depending on whether the earnings come from one or two workers.

Source: Edward J. McCaffery, *Taxing Women*, pp. 146-150, based on Daniel R. Feenberg and Harvey S. Rose, "Recent Developments in the Marriage Tax," *National Tax Journal*, 1995.

Lower-Income Marriage Penalties

One of the most widely misunderstood features of current tax law is the so-called "marriage penalty." Often thought to be a large problem for higher income families, in reality it is especially severe for low-income families.

The penalties arise because the government terminates various benefit programs, the most important being the Earned Income Tax Credit, without considering marital status. For example, as of 1994, an individual with one child who earned approximately \$10,000 would receive a check for \$2,000 from the government as part of the Earned Income Tax Credit program. However, if that person marries, the couple's income is combined, which can substantially decrease the benefits. If a family's income increases above \$15,000, the family will lose 20 percent of the credit until it is phased out altogether when income reaches \$25,000 or more. As a result, a couple in which each spouse earned \$10,000 would have paid a "marriage penalty" of \$3,717 in 1994, an astoundingly high amount in absolute and relative terms.

In contrast, a couple in which each spouse earned \$25,000 -- a combined family income two-and-a-half times greater and not eligible for the

earned income tax credit -- would have paid a marriage penalty of just \$727, less than one-fifth as much. Not until incomes are much higher does the marriage penalty begin to approach in size the penalty applied to low-income couples (see Table 2).

The Combined Effect on Women

These six features of the tax code combine to constitute a substantial bias against married women with children who work outside the home. To illustrate, consider the following example of an upper-income family. A husband employed as a lawyer makes \$60,000 a year. His wife and mother of their two children is offered a full-time job paying her \$30,000 a year. How much of a raise would the husband have to get to match the take-home effect of her potential job?

With federal income, Social Security, and state and local taxes, the wife is in at least a 50 percent tax bracket -- actually higher than her husband's once he has passed through the maximum salary on which Social Security contributions are collected, presently \$60,000. Therefore, her \$30,000 is cut to \$15,000 just on the basis of taxes. If the family must pay \$200 a week for child care, this will cost

\$10,000 over a 50-week year, for which the tax laws will reimburse them less than \$1,000 via the current child care tax credit. Her net is down to \$6,000 (deducting all the child care costs from her earnings). If we now add an additional \$100 a week in costs associated with employment outside the home -- for example, commuting, clothing, dry cleaning, household help, more restaurant meals, etc. -- the wife's \$30,000 will bring in a bottom line of only about \$1,000.²

The husband, whose additional work will not cause the need for child care or, most likely, any of the other major additional expenses noted above, can match his wife's \$30,000 job offer with only a \$2,000 raise. A differential 15 times greater *before* taxes and expenses are taken into account becomes no difference at all once they are.

The impact of taxes on employed wives and mothers is dramatic. *Essentially, the combined effect of all these tax provisions encourages the wife not to work.* The entire tax code (including all taxes) is so big (it takes up a third of the national economy in terms of how much money it raises, which is approximately \$2 trillion per year) that any biases it has inevitably ripple through the social life of the nation. Because, as government statistics indicate, nearly 90 percent of U.S. women will get married and almost 85 percent will have children, the category of married mothers is especially important. Meaningful tax reform would redress the biases against this large and important group. Yet the Congress and President have recently approved a tax reform plan that ignores this issue.

Policy Implications

Each of the problems in the tax system that creates a bias against employed wives has a fairly easy legislative solution. Unfortunately, although the following five answers have been widely known and readily available for many years, American lawmakers have refused to seriously consider them.

Separate Filing: Under a system of separate filing, husbands and wives fill out their own individual tax forms. This system has what is called "marriage neutrality," because marital status makes no differ-

ence on an individual's or couple's total tax due. Under separate filing, married women who work outside the home would face an initial zero bracket, just as their husbands do.

Social Security Reform: Social Security reform would give secondary earners an exemption for at least some part of the range in which they are now paying taxes with no corresponding benefits, for example owing no Social Security taxes on earnings up to \$10,000. The calculations could be done on the income tax form, resulting in a rebate to married employed women for their overpayments of Social Security taxes. A \$10,000 exemption level for secondary-earning wives would lead to a rebate of more than \$1,500.

Larger Child Care Deductions: The current tax law provisions for child care are inadequate. Larger child care deductions would allow more wives to consider working or remain in the labor force and would increase the funds available to families to pay for child care. A secondary-earner deduction over and above the child care deductions would help meet the added costs of commuting, clothing, meals, and so forth that accompany having two earners in a family.

Fringe Benefit Reform: The law should allow secondary-earner wives whose spouses already provide fringe benefits to opt out of an employer's coverage and get cash, preferably tax-free, since fringe benefits for primary-earning men are untaxed. (The same provisions should apply to husbands receiving benefits through their wives' employment.)

Eliminate Lower-Income Marriage Penalties: Welfare and "workfare" features, such as the Earned Income Tax Credit, should be redesigned so that lower-income individuals would not lose the credit when they marry.

Notes:

¹ According to the Bureau of Labor Statistics, wives are providing more than 35 percent of family income on average.

² Of course, many wives might not view these types of spending as "costs" -- better clothing, eating out more, and not having to do housework may well constitute some of the benefits for which an upper-income wife works.

This fact sheet, which summarizes the book Taxing Women by Edward J. McCaffery, is adapted from an article "Taxing Women: How the Tax Code Discriminates Against Women and Families," by Edward McCaffery, published in "California Lawyer," April 1997 (pp. 37-41). Edward McCaffery is professor of law at the University of Southern California Law School and the California Institute of Technology and can be reached by phone at (213) 740-2567 or by e-mail at emccaffe@law.usc.edu. This Research-in-Brief is part of a series by IWPR which highlights the work of IWPR's affiliates on topics of importance to women. It was written by Edward McCaffery, with the assistance of Natalie A. Markman and Shannon Garrett, and prepared by Jill Braunstein in September 1997. The Institute is an independent, nonprofit research organization dedicated to conducting and disseminating research that informs public policy debates affecting women. Members of IWPR receive regular mailings including fact sheets such as this. Please see below or contact the Institute for further information about individual and organizational memberships.

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